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August 25, 1993

William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W.
Washington, D.C. 20554


Re: Implementation of the Cable Television Consumer
Protection and Competition Act of 1992 -- MM
Docket No. 93-215

Dear Mr. Caton:

I enclose an original and nine (9) copies of the
Comments of the City of Seaford, Delaware, in the above captioned
proceeding.

Any questions regarding this submission should be
referred to the undersigned.

Sincerely,


Janice L. Lower
Counsel for the City of
Seaford, Delaware

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AUG 25 1993

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

Implementation of Sections of
the Cable Television Consumer
Protection and Competition Act
of 1992

MM Docket No. 93-215

Rate Regulation

TO: THE COMMISSION

COMMENTS OF THE CITY OF SEAFORD, DELAWARE

I. INTRODUCTION

The City of Seaford, Delaware, hereby submits comments in response to the Notice of Proposed Rulemaking ("NPRM") in the above-captioned docket, adopted on July 15, 1993, and released on July 16, 1993. In the NPRM, the FCC proposes regulatory requirements to govern cost-of-service showings submitted by cable operators seeking to justify rates above levels determined under the Commission's established primary method of regulating basic service tier rates, the benchmark and price cap approach. The FCC issued the NPRM in response to its concerns that the record created in the Rate Regulation Docket, MM Docket No. 92-266, was not sufficient to permit the balancing of consumer and cable operator interests that should be embodied in a cost-of-service approach, and seeks by this NPRM to create the record necessary to adopt cost-of-service requirements. NPRM at 5, Paragraph 5.

In these comments, Seaford urges the FCC to reconsider its proposal to adopt a generic cost-of-service approach, and

instead urges the Commission to determine that the existing benchmark and price cap approach is just, reasonable, and fair, and provides sufficient opportunity for achieving a complete regulatory approach to regulation. Nevertheless, should the Commission conclude that a complete regulatory framework for cable rate regulation requires a comprehensive cost-of-service regulatory scheme, Seaford urges this Commission to consider the impact that the cost-of-service approach will have on smaller franchising authorities such as Seaford which intend to regulate the rates of their cable operators.

II. BACKGROUND

A. City of Seaford

The City of Seaford, Delaware, is the franchising authority for its cable operator, Storer Cable Communications. Storer serves approximately 1,700 cable subscribers in the City of Seaford. Under Delaware state law, incorporated municipalities will act as the franchising authorities for their municipal franchise areas. Seaford will file a Certification Form (Form 328) on or about September 1, 1993, to become the regulator for Storer. Seaford is also currently contemplating filing a complaint at the FCC for the review of Storer's programming tier service rates. Seaford intends to enforce the FCC's customer service standards as set forth in this Commission's final rule.

B. Context of the NPRM

Rate regulation can be very complicated, costly and time-consuming. In establishing the benchmark and price cap

formula in MM Docket No. 92-266, the Commission struck a fair compromise between the interests of operators and of smaller franchising authorities like Seaford. While creating a generally applicable regulation methodology that is relatively easy to utilize and apply, the benchmark and price cap system, the Commission also gave cable operators the option to elect to present a cost-of-service showing, if costs could justify rates that were above those established under the benchmark system. In its earlier rule, the Commission declined to permit local and state cable television authorities to undertake an initial cost-of-service showing to establish rates for the basic service tier below those established under the benchmark system (but if a cable operator chose a cost-of-service approach, and costs justify a rate reduction, the regulator may lower rates--so the operator assumes something of a risk in selecting that approach).

In the NPRM at hand, the FCC has requested comments on the cost-of-service methodology that it will make applicable to cable rates. Seaford is familiar with cost-of-service ratemaking, as it owns its own electric system and purchases electric power and energy from a public utility whose rates are regulated under a cost-of-service methodology by the Federal Energy Regulatory Commission (FERC). In Seaford's years of experience before the FERC, it has learned that cost-of-service rate regulation requires knowledge of many esoteric variables, complex formulas, and industry practices, and almost always requires the assistance of attorneys, accountants and economic consultants. It is a complex, expensive, and time-consuming

regulatory process. While Seaford is normally an intervenor in cost-of-service proceedings at the FERC, it is all too aware that, under the FCC scheme, it would be the regulator. Seaford has concerns about the amount of time and financial resources that would be necessary to hold cost-of-service review proceedings for cable rates in the City, by the City's government.

Under any regulatory scheme allowing a cost-of-service analysis, cable operators, including Storer, will elect cost-of-service showings when they are fairly confident of their likelihood of justifying rates that would be higher than the benchmark. Therefore, should the Commission adopt this approach on a widespread basis, it may be anticipated that at least some regulatory activity by municipal franchising authorities such as Seaford will be on a cost-of-service, and not a benchmark and price cap, basis. The FCC should bear fully in mind that successful cost-of-service showings will result only in higher rates for consumers than the benchmark mechanism, at considerably greater effort and cost on the part of local regulatory authorities as to the basic service tier, and on the part of the FCC, as to the cable programming service tier. The increased effort and expense to both the local regulators and to the Commission may well chill the desire of regulators such as Seaford to take full advantage of the opportunities to establish just and reasonable rates, as provided by Congress in the Cable Act of 1992.

For large metropolitan areas with many thousands of cable subscribers and significant financial resources, conducting a full-blown cost-of-service analysis would be an involved but worthwhile undertaking. But for a small city or town, with two or three thousand subscribers, to hire lawyers and economists who can teach the cost-of-service concepts to the City or Town Council members or the members of the local cable committee, would be a serious effort. To analyze the cable operator's cost-of-service information sufficiently, to conduct hearings, and to understand the complicated economic concepts clearly enough to reach a reasonable result, may all be far beyond what seems reasonable under the authority given to the municipality by Congress to make sure its cable television rates are proper. And it is hard to envision how the FCC, already feeling the burden of its vastly increased regulatory role, will be able to conduct what could be hundreds of cost-of-service proceedings relating to the programming tier rates.

Should these scenarios be the conceivable or predictable result of this NPRM, then the FCC should very seriously examine whether a generic cost-of-service approach sends the wrong signal to both operators and franchising authorities, and whether it in fact completely undermines Congress' overall intent.

From the point of view of local cable regulatory bodies, therefore, the cost-of-service mechanism does not offer much "WIN-WIN" potential. As a general principle, Seaford would prefer to see the Commission return to the benchmark approach,

and see the FCC direct its efforts at refining that approach to better address some of the concerns of the cable industry. The cost-of-service mechanism which will be designed or refined in this proceeding, should be used only in very limited, exceptional circumstances, since it will produce higher rates at greater cost and effort than those permitted under the benchmark system. In this regard, Seaford supports the Commission's proposal, in Paragraph 18 of its NPRM, to limit cost-of-service showings as to initial regulated rates to "special circumstances of extraordinary costs". This facilitates prompt initiation of rate regulation, for the benefit of subscribers, without undue burden on local franchising authorities like Seaford and, by definition, without unduly prejudicing cable television systems.

III. COST OF SERVICE PRINCIPLES

Should this Commission determine that a generic cost-of-service approach is still appropriate to develop for the cable industry, Seaford makes the following comments on the FCC's NPRM.

If a mix of the two regulatory schemes is put into place by the Commission, local franchising authorities such as Seaford should be granted increased latitude when making decisions regarding a company's request to be switched from one regulatory system to another. In such circumstances, regulatory bodies should be given the power to determine the actual basis of cost differentials from the national norm. The local franchising authority should be able to determine whether high costs claimed by cable companies are the result of inefficient, unsupported costs and internal company decisions or extraneous factors such

as local taxes, and to take those into account in ruling on the rates. Moreover, the franchising authority should be able to initiate a cost-of-service proceeding when it may choose to, for example, in the face of declining costs that should result in lower rates to consumers.

On the FCC's proposal to establish limits on the frequency with which cable operators may make cost-of-service showings for the basic service tier and cable programming services tier to no more than one a year,¹ Seaford agrees that such a limitation is appropriate, since it will minimize the burden imposed by the cable companies upon regulatory bodies. Indeed, a three-year regulatory cycle may be appropriate for company-initiated cost-of-service showings, with the exception noted above that regulatory authorities should be given the discretion to initiate off-cycle showings, based on reported cost information of the cable operators, or economic circumstances such as declining costs. At a minimum, the Commission should direct that a new cost-of-service showing cannot be submitted until the decision regarding the previous cost-of-service or benchmark/price cap proceeding has become "final", and is no longer subject to administrative or judicial review. Otherwise, multiple proceedings could be pending at the same time, given the time that can be consumed by review processes.

In order to obtain reported information in the most efficient and useful form possible, cable companies and operators should be required to file annual financial reports based on or

¹ NPRM at 11, ¶ 17.

in a format similar to the Automated Reporting Management Information System (ARMIS) reports currently required of the Telephone Local Exchange Companies (LECs). This would allow regulatory authorities to have the information to initiate cost-of-service proceedings preemptively when costs drop to levels sufficient to justify the expense of a new proceeding. With the cost-of-service information available to local regulatory authorities on an annual cycle, to be used if needed, the formal review process could be lengthened to a triennial cycle, reducing the administrative and regulatory costs of proceedings.

Seaford believes that cable operators should not be allowed to make cost-of-service showings for existing rates, unless they present overwhelming and preponderant evidence to justify an increase in rates. "Special circumstances" or "extraordinary costs" should be clearly defined to exclude costs that are the product of mismanagement of the finances or the operations of the company. The shareholders should bear the costs of mismanagement and improper decision making, since that provides their incentive to insure good management in the future.

Seaford also supports the Commission for prescribing a form for cost-of-service studies. A uniform format for as much information as possible is essential for the smooth transition into a regulated environment for this industry, since it will decrease the "learning curve" associated with the analysis of new studies. And cable operators such as Storer should be required to copy their files onto a disk for provision to the franchising

authority such as Seaford. Seaford has the computer facilities to read and utilize such formatted information, and Storer and other operators should be required to provide it in the most efficient manner possible. This would save time and make the process of regulating cable companies simpler and more standardized.

On factors in the cost of service standard itself, should the FCC find that a cost-of-service methodology should be made available to cable operators, Seaford would support the following.

- o The Commission's tentative conclusion that plant specific costs, plant non-specific costs, customer operations, and corporate operations should be included as operating expenses is appropriate. Any expenses associated with the lobbying of elected officials should not be included in the allowed expenses, whether classified as advertising or not. Consumers should not have to bear the costs of cable companies' lobbying efforts.

- o The Commission should prescribe depreciation rates for purposes of developing cost-based rates for regulated cable service. In capital intensive industries such as the cable industry, the most significant element of a cost-of-service study is depreciation expense. Since Generally Accepted Accounting Principles do not prevent cable operators from selecting accelerated and excess depreciation rates, the prescription of depreciation rates by the Commission is essential. Cost-of-service studies based upon company-selected depreciation rates would be meaningless. The Commission has prescribed

telephone depreciation rates for nearly 50 years, and its expertise is unsurpassed in this area. The Commission should apply to the cable industry all of the methods and procedures it uses to prescribe depreciation rates for local exchange telephone companies.

- o The inclusion of taxes (subject to review for accuracy during the regulatory proceeding) incurred in the provision of regulated cable services in the annual expenses of cable operators is appropriate.

- o The used and useful and prudent investment standard for inclusion of an asset in the ratebase should be applied to cable operators. Without the "used" criteria, cable television ratepayers in Seaford and elsewhere could be saddled with the burdens of stranded plant and extraneous plant in the ratebase. Management would have no incentive to be prudent and efficient in investments and would benefit from the application of a rate of return to an inflated ratebase. Without the "useful" criteria, Seaford's ratepayers also could be saddled with unnecessary investments, and Storer's management and shareholders could benefit from making unneeded investments. Without the "prudent" criteria, management would be tempted to engage in the speculative activities that Congress sought to curb through the Cable Act.

- o Original cost is the only legitimate method of determining cost for valuing ratebase; every other method is subject to manipulation by the cable companies. It is also by far the simplest method of evaluation, and would result in the

least amount of regulatory burden to rate proceedings. As discussed above, local regulators of cable franchisees will have in general limited resources for the regulation process. The original cost method--and only that method--is appropriate to determine the value of a cable operator's plant in service for ratebase purposes.

- o Goodwill and intangibles are legitimate designations of the value of the good name of a company that has instilled loyalty in its consumers and is likely to give them legitimately won high earnings in the future. Goodwill is not the appropriate term or accounting method for the excess value which an unregulated monopolist can wring out of its captive ratepayer. None of the purchase price of a cable system in excess of the value of the plant in service should be assigned to goodwill or intangibles.

- o The application of the long-standing used and useful criteria for inclusion of plant in ratebase is appropriate, and should be maintained by this Commission. The Commission should not allow cable operators to include construction work in progress (CWIP) in rate base absent a showing of severe financial distress. CWIP is not plant that is used and useful, and customers are not receiving any service from such facilities. Also, the investments that cable operators make are not typically so large in proportion to the overall investment as to warrant such treatment. The financial condition of the operator is not so dependent upon earning a return on new investments as to threaten the viability of the enterprise. Finally, investment in

new cable or other plant is generally placed into service quickly enough that CWIP allowances are not necessary. Accordingly, the Commission should exclude any CWIP from rate base, absent a showing of severe financial distress.

- o The Commission should adopt a zero working capital allowance in the absence of a comprehensive lead-lag study documenting a different result. The billing cycles for cable subscribers should provide cable operators with a cash flow that generally matches the incurrence of expenses. Should any working capital allowance be found to be appropriate, it should be on an industry-wide basis. The balance sheet approach is readily subject to manipulation and can result in an excessive rate base. While a one-time lead-lag study would be necessary to establish an industry-wide allowance, the use of a lead-lag study on a continuing basis would be excessively burdensome on all involved.

- o The Commission should establish a single rate of return for the provision of regulated cable service by all cable operators, just as it has maintained a single rate of return for the interstate access services of all local exchange carriers. The rate of return should be established to reflect the risk level inherent in the provision of regulated cable service. This risk is comparable throughout the nation. Individual company financial structures and arrangements should not be allowed to impose burdens on the ratepayers.

- o The Commission should prescribe a rate of return for the cable industry no higher than that currently in effect for local exchange telephone companies. Indeed, the 11.25 percent

rate of return currently in effect for local exchange telephone companies is almost certainly excessive in today's environment,² where prime lending rates are in the middle single digit range. This return for local exchange telephone companies was adopted in September, 1990, and the cost of capital has fallen precipitously and continuously since then.

- o The Commission should establish a simple but uniform system of accounts for cable operators. The accounts listed in Appendix A to the NPRM appear to represent a satisfactory compromise between the need for reliable information and the need to minimize regulatory burden.

- o The Commission should adopt affiliate transaction rules for cable operators identical to those it has established for telephone carriers in Part 32.27 of its rules. The treatment of transactions with affiliates from Part 32.27 of the Commission's rules will be effective in dealing with asset transfers into or out of the regulated accounts of cable operators. Otherwise, with the mixed regulation scheme (having both benchmark and cost-of-service systems) proposed in this NPRM, a parent company could use transfers between affiliates under different regulatory schemes to inflate the costs of affiliates under cost-of-service systems and deflate the costs of affiliates under the prescribed benchmark.

- o The FCC should increase the amount of information available to local franchising authorities. A cable operator

² Represcribing the Authorized Rate of Return for Interstate Service of Local Exchange Carriers, Order, 5 FCC Rec 7507 (1990), (1990 Telco Represcription Order), ¶ 216.

with multiple affiliates, when submitting a cost-of-service study to the regulating authority of one affiliate, should submit the same study to all regulatory bodies that oversee any of the operator's affiliates (whether each affiliate is using a cost-of-service or a benchmark approach). At a minimum, all regulatory bodies should be informed of cost-of-service showings in affiliates related to their cable service provider, and should be able to obtain those studies on request.

o The Commission should require all systems, including Storer, to submit data annually. In addition to the data requested in Appendix B to the NPRM, the Commission should require an earned rate of return on rate base calculation with each report. Over time, such data has proven very valuable to regulators in the exercise of their oversight responsibilities. Each annual report should include an attestation by an independent auditor that the report has been prepared in accordance with the Commission's accounting and affiliate interest rules.

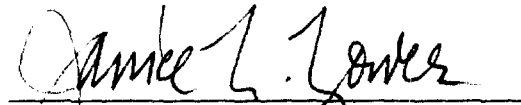
VI. CONCLUSION

The cost-of-service approach proposed by the FCC in this NPRM, particularly where it is offered to cable operators as a constantly available alternative to the benchmark approach, will be inordinately complex and burdensome to local franchising authorities acting as regulators, such as Seaford, and will not result in the most reasonable cable service rates. The City of Seaford instead supports either a much simplified cost-of-service approach, or preferably a benchmark and price cap approach

refined to address and include fundamental cost-of-service issues. Should the Commission conclude that a cost-of-service alternative is nevertheless appropriate, it should take into consideration all of the issues addressed herein, and design its final rule to eliminate the unjust and unreasonable impact certain of its tentative conclusions would create.

Dated: August 25, 1993

Respectfully submitted,



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